



THOMAS F. REILLY  
ATTORNEY GENERAL

## THE COMMONWEALTH OF MASSACHUSETTS OFFICE OF THE ATTORNEY GENERAL

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December 29, 2005

Mary L. Cottrell, Secretary  
Department of Telecommunications and Energy  
One South Station, 2nd Floor  
Boston, MA 02110

**Re: Boston Edison Company, Cambridge Electric Light Company,  
Commonwealth Electric Company, NSTAR Gas Company,  
D.T.E. 05-85**

Dear Ms. Cottrell:

On December 28, 2005, ISO-New England (ISO-NE) filed Comments on the proposed Settlement Agreement. By this letter, the Attorney General replies to these late filed comments.<sup>1</sup>

ISO-NE urges the Department of Telecommunications and Energy (Department) to reject the provisions of the Settlement Agreement that provide for possible incentive mechanisms if NSTAR Electric is successful in efforts to advocate on behalf of customers on issues relating to market structure and efficiencies. ISO-NE asserts that approval of the Settlement “could lead to litigation positions and tactics by NSTAR that will disrupt productive and efficient processes already established to resolve wholesale market issues and that will actually redound to the end-use customers’ detriment.” ISO-NE Comments, p. 3.

Contrary to the ISO-NE’s objections and in response to similar comments by Constellation Energy Commodities Group, Inc., the Company has publicly stated that it “intends only to take reasonable positions in advocating on behalf of its customers. . . .” NSTAR Reply Comments, p. 9-11. ISO-NE has provided no evidence that NSTAR in fact will act differently than it has represented to the Department.

The Attorney General has consistently called on regulatory entities to protect consumers. On December 13, 2005, the Attorney General requested that ISO-NE to take immediate action to curb the exercise of market power in the Boston/Northeastern Massachusetts (NEMA) area.

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<sup>1</sup> Comments were due in this proceeding no later than the close of business on December 20, 2005.

See Attachment. Since at least June 15, 2005, ISO-NE has known that one generation supplier has been exercising local market power in the Boston area.<sup>2</sup> This exercise of market power has cost Massachusetts retail customers almost \$100 million in higher Daily RMR Uplift Costs. The cost impact on the customers of NSTAR Electric, TransCanada, Select Energy, the Massachusetts Municipal Electric Company and Harvard Dedicated Energy Limited is estimated to be 0.5¢/kWh. Instead of moving immediately on Dr. Patton's recommendations, it now appears that ISO-NE no plans to address this problem.

ISO-NE related charges are skyrocketing not only in Boston, but across the state. ISO related expenses threaten Department approved retail rate agreements designed to mitigate today's high cost of energy.<sup>3</sup> High utility rates can put our businesses at a competitive disadvantage compared to other regions of the country. Massachusetts' consumers and businesses are facing some of the highest costs for natural gas and electricity services in the country. Many families struggled to pay high heating bills last winter and will find it even more difficult this winter as rates rise yet again. Clearly, public officials must work with the state's electric utilities to minimize the harmful impacts these costs have on consumers and on the state's economy.

As the Department has previously held "incentive regulation holds promise for improvement in the current regulatory framework, regardless of the competitive state of the industries." *Incentive Regulation*, D.P.U. 94-158, p. 40 (1995). In fact, incentive regulation is "potentially more compatible with increasing competition than traditional COS/ROR regulation. . . ." *Id.* The incentive provisions of the Settlement Agreement are consistent with the Department's primary objective with incentive regulation, to "provide marketplace benefits to consumers by promoting more efficient utility operations, cost control, and opportunities for reduced electric and gas rates. *Id.*

ISO-NE's arguments must be rejected by the Department.

Sincerely,

Joseph W. Rogers  
Chief, Utilities Division

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<sup>2</sup> See "2004 Assessment of the Electricity Markets in New England", David B. Patton, Ph.D., ISO Independent Market Monitor.

<sup>3</sup> See *Western Massachusetts Electric Company*, D.T.E. 04-106, Attachment 8, page 1 of 3. The Company is projecting a \$6,004,198.00 increase in ISO Expenses. If allowed, these ISO expenses will result in a \$0.15/kWh rate increase.

cc: Eric J. Krathwohl  
Kathleen A. Carrigan  
Service List

December 13, 2005

William W. Berry, Chairman  
Gordon van Welie, President  
ISO New England  
One Sullivan Road  
Holyoke, MA 01040-2841

Dear Chairman Berry and President van Welie:

I am asking the ISO-New England to take immediate action to curb the exercise of market power in the Boston/Northeastern Massachusetts (NEMA) area. Sempra Energy, the marketing manager of the Mystic generating units in Everett, Massachusetts, has been unfairly manipulating the wholesale market rules and driving prices of electric power in NEMA to unreasonable levels. I know that the ISO has not publicly identified Sempra as the Company involved, but the ISO's proposed solution targets the operation of combined cycle units, and the only combined cycle units in NEMA are the Mystic Units. *See Mark Montalvo Memo to Markets Committee Members and Alternates, Re: August 9, 2005 Presentation of Proposals to Reduce NEMA Uplift (August 23, 2005).*

On June 15, 2005, David B. Patton, Ph.D., the ISO's Independent Market Monitor, issued his "2004 Assessment of the Electricity Markets in New England", *Independent Market Monitoring Unit, ISO New England Inc.* In his Executive Summary, Dr. Patton concluded that:

"in late 2004 one supplier began exercising local market power in the Boston area, and its conduct resulted in considerable increases in the operating reserve payments to the supplier."

This exercise of market power has created an impact on wholesale and retail suppliers/markets. This year's financial impact on Massachusetts retail customers in higher Daily RMR Uplift Costs has been approximately \$70 million through September 2005. And according to Markets Committee Materials, (August 8 - September 5, 2005) "NEMA Daily RMR UpLift Costs:" Tom Murrell, the cost impact on the customers of NSTAR Electric and Gas, TransCanada, Select Energy, the Massachusetts Municipal Electric Company and Harvard Dedicated Energy Limited is estimated to be 0.5¢/kWh.

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I understand from Mr. Montalvo's August 23, 2005 memo to Markets Committee Members, that the ISO has proposed a 25-week schedule for the development of a solution to require more flexible dispatch of combined cycle units. The ISO had attempted to solve this problem in May 2005, but by August 2005, it was clear that the attempted solution did not work. I also understand from market participants that the ISO has not yet begun the 25-week schedule because it has transferred personnel assigned to this matter to the winter emergency-planning project. While I can appreciate the need to address this winter's natural gas supply issues, NEMA customers face huge price spikes for electric power this winter. Sempra Energy is manipulating the market in ways that maximizes its profit to the detriment of customers in Massachusetts. While not technically illegal under the ISO's market rules, Sempra's behavior exploits a loophole in those rules that needs to be corrected immediately.

Sempra's actions should come as no surprise to the ISO. In our joint February 2002 study examining the "competitiveness" of the New England wholesale power market, Dr. James Bushnell identified the precise factors in play in Sempra's current behavior, and said that each of these factors provides an opportunity for generators to exercise market power while technically operating within market rules. He identified those factors as differences between day ahead commitments and real-time operations of generating units; transmission congestion management practices; the ability of generating units to self-schedule; and characterization of individual unit operation constraints such as ramping time and minimum operating levels. The ISO has been aware of this particular "gaming" by Sempra since at least Dr. Patton's June 2005 assessment, but has yet to take action to stop this behavior. Instead of moving immediately on Dr. Patton's recommendations, it now looks as though the ISO will not have a solution for this problem until at least May 2006.

It is essential that customers be protected from the exercise of market power by wholesale generators. The existence of market power and the failure of the ISO to immediately address this issue raise concerns as to whether the NEMA area remains workably competitive and a regime of market-based rates is appropriate. *See Richard Blumenthal, Attorney General for The State of Connecticut, et al. v. ISO-New England, Inc., Docket No. EL05-150-000.*

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I therefore request that the ISO immediately take action to address this known exercise of market power.

Sincerely,

Thomas F. Reilly

CC: Chairman Joseph T. Kelliher  
Commissioner Nora Mead Brownell  
Commissioner Suede G. Kelly  
Federal Energy Regulatory Commission